Gramm stressed the trend toward uniform national standards for securities regulation when he introduced SLUSA, stating that "[l]egislatively, we have been moving toward national standards for national securities. The National Securities Markets Improvement Act . . . created national rules for many aspects of our national securities markets. [SLUSA] is an important step continuing in that direction, a step in line with the principles behind the commerce clause of the Constitution." 143 Cong. Rec. S10475 (daily ed. Oct. 7, 1997). The trend toward uniform national regulation of the securities market is also evident in international markets. *See* Karmel, *Reconciling Federal and State Interests*, 28 Brook. J. Int'l L. at 547 (surveying changes in securities regulation in the United States and Europe and concluding "[a]s securities markets have become national and even international and significantly affect the national economic welfare in the U.S. and the EU-wide markets in Europe, there has been a trend toward federalizing securities regulation").

Courts have likewise recognized that the securities market is both national in character and essential for the efficient distribution of capital. As this Court has noted, "[l]arge corporations that are listed on national exchanges, or even regional exchanges, will have shareholders in many States and shares that are traded frequently. The markets that facilitate this national and international participation in ownership of corporations are essential for providing capital not only for new enterprises but also for established companies that need to expand their businesses." *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69, 90 (1987). State courts likewise recognize that the national character of the securities market. *See Guice v. Charles Schwab & Co.*, 674 N.E.2d 282, 290 (N.Y. 1996) (holding New York law preempted by federal regulations because it "would inevitably defeat the congressional purpose of enabling the SEC to develop and police [a] 'coherent regulatory structure'

for a national market system."); *Dahl v. Charles Schwab & Co.*, 545 N.W.2d 918, 925 (Minn. 1996) ("There is no denying the fact that the securities industry has a national or, if more broadly considered, an international scope.").

SLUSA protects the federal policy of encouraging efficient securities markets by preventing circumvention of the Private Securities Litigation Reform Act of 1995. In 1997, the Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs held oversight hearings on the operation of the PSLRA. The committee, after hearing extensive testimony, concluded that there was a measurable shift of securities class-action litigation from federal to state court after the passage of the PSLRA. S. Rep. No. 105-182, at 3. Studies showed that although there was a reduction in the number of securities class actions filed in federal court, that reduction corresponded with a similar increase filed in state courts.[3] *See* Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 Stan. L. Rev. 273, 307-18 (1998). The Senate Committee concluded that the trend toward state class-action litigation "created a ripple-effect that has inhibited small, high-growth companies in their efforts to raise capital, and has damaged the overall efficiency of our capital markets." S. Rep. No. 105-182, at 4. The Committee expressed specific concerns that the prospect of class actions in state court discouraged corporations from using the "safe-harbor" provision of the PSLRA, which was

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[3] *See also* Stephen J. Choi, *The Evidence on Securities Class Actions*, 57 Vand. L. Rev. 1465, 1498 (2004). Choi's study confirmed that frivolous securities class-action suits were common in federal court before the PSLRA. He also concluded that post-PSLRA, the number of frivolous suits filed in federal court decreased and there was thus a shift toward meritorious suits. His study reviews only federal filings.

designed to encourage corporations to share valuable forward-looking information with investors. *Id.*

The Committee also stressed that although state regulators play a complementary role in regulating securities markets, SLUSA was necessary because defendants in state-court class actions were denied the protections promised by the PSLRA. *Id.* at 5. The Committee report noted that there was some concern that preempting state securities class actions violated federalism principles, but concluded that "the interest in promoting efficient national markets . . . [is] the more convincing and compelling consideration in this context." *Id.* at 4. The Senate bill as well as the final version approved by the Conference Committee and enacted by Congress were patterned after the NSMIA in that both acts were intended to create uniform national standards in their respective fields. *See* H.R. Conf. Rep. No. 105-803, at 13 (1998) ("Consistent with the determination that Congress made in the National Securities Markets Improvement Act (NSMIA), [SLUSA] establishes uniform national rules for securities class action litigation involving our national capital markets." (footnote omitted)).

SLUSA thus implements the Senate Banking Committee's conclusions that securities class actions had shifted from federal to state court, that the shift prevented the PSLRA from achieving its important objective of reducing frivolous class-action litigation, and that "it is appropriate to enact national standards for securities class action lawsuits involving nationally traded securities, while preserving the appropriate enforcement powers of State securities regulators and not changing the current treatment of individual lawsuits." SLUSA, § 2(5), 112 Stat. 3227. *See Lander v. Hartford Life & Annuity Ins. Co.*, 251 F.3d 101, 107-08 (2d Cir. 2001) (SLUSA "mak[es] federal court the exclusive venue for class actions alleging fraud in the sale of certain

covered securities and . . . mandat[es] that such class actions be governed exclusively by federal law.").

II. The Need For Uniform National Regulations That Promote Efficiency In The Securities Market And The Free Flow of Capital Is An Important National Interest That Justifies Congress's Preemption Of State Securities Class Actions Alleging Fraud.

A. Although the Primary Purpose of Federalism is to Protect the Role of the States in our Federal System, a Necessary Corollary to that Purpose is Respecting the Essential Role of the National Government to Regulate in Specific Spheres.

The Commerce Clause of the Constitution grants the federal government the power "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. Const. art. I, § 8, cl. 3. By virtue of the Supremacy Clause, regulations promulgated under the Commerce Clause supersede state law. *See* U.S. Const. art. VI, cl. 2. James Madison explained the Commerce Clause's delegation of power by pointing out that uniform national regulation benefited the states: "A very material object of this power was the relief of the States which import and export through other States from the improper contributions levied on them by the latter. Were these at liberty to regulate the trade between State and State, it must be foreseen that ways would be found out to load the articles of import and export, during the passage through their jurisdiction, with duties which would fall on the makers of the latter and the consumers of the former." The Federalist No. 42, at 276 (James Madison) (Isaac Kramnick ed., 1987). Alexander Hamilton justified the delegation on the basis that national regulation created a unified market that made the United States a competitive force in international commerce. The

Federalist No. 11, at 129-32 (Alexander Hamilton) (Isaac Kramnick ed., 1987).

Regulation of national securities markets is at the core of the power allocated to the national government in our federal scheme. *See generally*, Larry Kramer, *Understanding Federalism*, 47 Vand. L. Rev. 1485, 1502 (1994) ("There are, after all, two sides to federalism: not just preserving state authority where appropriate, but also enabling the federal government to act where national action is desirable."). At the same time, the considerations that favor protection of state prerogatives, such as protecting individuals by providing a check on national power and encouraging citizen involvement by localizing government, are not implicated here. *See* Perino, *Fraud and Federalism*, 50 Stan. L. Rev. at 320-21. Other federalism principles, such as allowing the states to function as "laboratories" for innovation, *see New State Ice Co. v. Leibmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting), and allowing state government flexibility in responding to local issues, *see Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970), have less force here because experience has shown that giving States a free hand to craft their own standards for securities class actions generates an unacceptably high risk of the kinds of vexatious strike suits (with their coercive pressure to settle unmeritorious claims) that federal law seeks to minimize as a matter of national policy.[4]

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[4] Furthermore, SLUSA is carefully drawn to protect the interests of States by preserving state law in situations where Congress has determined that these risks are not as severe. It applies only to "covered class actions" involving (1) fifty or more named plaintiffs where common questions of law or fact predominate, (2) class actions brought on behalf of unnamed class members, and (3) consolidated suits alleging common questions of law or fact seeking damages for more than fifty plaintiffs. 15 U.S.C. § 77p(f)(2)(A). SLUSA also excludes (1) class actions alleging violations

B. Regulating the National Securities Market is Not a Purely Local Concern.

Regulatory competition among the States is beneficial only where the regulated individuals have real choice. Corporations with securities traded on national exchanges cannot control where their securities are traded. Unlike the market for corporate governance law where a corporation chooses a state of incorporation and opts into its laws, fraud liability is premised on the location of the transaction. Perino, *Fraud and Federalism*, 50 Stan. L. Rev. at 325; UNIFORM SECURITIES ACT § 801 (1985). The absence of real choice in the market for legal standards in securities regulations undercuts the value of the states experimentation. If the corporations are not able to opt out of inefficient liability regimes, the States lack incentives to structure competitive liability rules and "the virtue of innovation disappears and what remain are fifty petty and stultifying tyrannies, rather than fifty laboratories of experimentation." Charles Fried, *Federalism--Why Should We Care?*, 6 Harv. J.L. & Pub. Pol'y 1, 3 (1982-1983).

The application of state fraud laws to securities traded on national exchanges in the form of class-action lawsuits gives

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of the statutory or common law of the state in which the issuer is incorporated, (2) actions brought by a state on its own behalf, as a member of a class comprised of other states, or on behalf of a state pension plan, and (3) actions brought on contractual agreements between issuers and indenture trustees. 15 U.S.C. § 77p(d)(1)-(3). Congress also reserved the authority of state securities regulators to investigate violations and bring enforcement actions based on state law. 15 U.S.C. § 77p(e). Finally, derivative actions based on state corporate law are not preempted. 15 U.S.C. § 77p(f)(2)(B). *See generally*, A.C. Pritchard, *Constitutional Federalism, Individual Liberty, and the Securities Litigation Uniform Standards Act of 1998*, 78 Wash. U. L.Q. 435, 491-94 (2000) (discussing the exceptions).

that law extra-territorial effect. Allowing extra-territorial application creates the risk of externalities because a state can shift the costs of complying with its law from its own citizens to the citizens of other states. *See* Michael W. McConnell, *Federalism: Evaluating the Founders' Design*, 54 U. Chi. L. Rev. 1484, 1495-96 (1987) (reviewing Raoul Berger, *The Founders' Design* (1987)). A state may have a tangential interest in applying its fraud statutes to protect resident shareholders of resident corporations, resident shareholders of nonresident corporations, and nonresident shareholders of resident corporations; however, as this Court emphasized in *CTS*, a state "has no interest in protecting nonresident shareholders of nonresident corporations." *CTS Corp.*, 481 U.S. at 93 (emphasis omitted). The lack of alignment between the interests of the state in enforcing its fraud laws on a class-wide basis and the cost of enforcement to the state and its residents enhances the risk of negative externalities.

The Senate Banking Committee report foresaw such a negative externality. To avoid liability in an integrated national economy with multiple jurisdictions, all of which may enforce their fraud statutes on a class-wide basis, corporations must conform their statements and forecasts to the most stringent standard, regardless of whether that standard is beneficial to the corporation's shareholders or national securities markets. Given the costs of litigation, risk-averse corporations might reasonably fail to take full advantage of federal safe-harbor provisions in contravention of federal policy. The Senate report cited that "chilling effect" on the use of the federal safe-harbor provision as one reason to adopt SLUSA. S. Rep. 105-182 at 4.

C. Differing Liability Rules in Class Actions Impose Significant Costs that Impair Efficiency and Increase the Price of Capital in the National Securities Markets.

1. This Court has Emphasized the Important Role of Clear and Consistent Fraud Rules in Achieving Efficient Markets.

This Court repeatedly has rejected attempts to expand civil fraud liability under the federal securities laws in an ill-defined or unclear way. In *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), the Court rejected the argument that individuals who neither purchased nor sold a particular security could bring a civil fraud action because it did "not believe that such a shifting and highly fact-oriented disposition of the issue of who may bring a damages claim for violation of Rule 10b-5 is a satisfactory basis for a rule of liability imposed on the conduct of business transactions." *Id.* at 755. The Court subsequently rejected the vague "substantial factor" test to determine liable parties under Section 12 of the Securities Act because that test "introduces an element of uncertainty into an area that demands certainty and predictability" and would result in "decisions . . . made on an ad hoc basis, offering little predictive value to participants in securities transactions." *Pinter v. Dahl*, 486 U.S. 622, 652 (1988); *see also Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 188-89 (1994) (rejecting aiding and abetting liability under Rule 10b-5 because of the inherent uncertainty such liability entails for secondary parties).[5]

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[5] Recent scholarship vindicates the Court's emphasis. *See* Rafael LaPorta, Florencio Lopez-de-Silanes, and Andrei Schliefer, *What Works in Securities Laws*, __ J. Fin. __ (forthcoming Feb. 2006), available at http://www.afajof.org/jofihome.shtml (follow "Forthcoming Articles"

2. *The Substantial Costs of Frivolous Class Action Litigation Impede the Efficiency of National Securities Markets.*

Class-action litigation, regardless of its merits, always imposes substantial costs. *See generally* Ralph K. Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America*, 42 Duke L.J. 945 (1993). The costs of frivolous class-action litigation are especially damaging to the markets because they impose a dead-weight loss on investors. The Senate committee report prepared after the hearings on the PSLRA emphasized the cost of class-action litigation, noting that in 1994 corporations and their insurers paid $1.4 billion to settle various securities lawsuits. S. Rep. No. 104-98, 8-10 (1995), *reprinted in* 1995 U.S.C.C.A.N. 683, 687-89. The average cost of settlement was $8.6 million. *Id.* More recent surveys report that settlement costs for all securities class-action suits have increased along with the length of the settlement process while the number of cases settling has decreased. *See* Mukesh Bajaj, Sumon C. Mazumdar, & Atulya Sarin, *Securities Class Action Settlements*, 43 Santa Clara L. Rev. 1001 (2003).

This Court has noted that "litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps*, 421 U.S. at 739. The danger is not

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hyperlink; then follow February 2006 hyperlink) (last visited Nov. 11, 2005). The authors survey the securities regulations of 49 countries and find, among other things, a positive correlation between judicial efficiency and developed financial markets. They conclude that the benefits of regulation typical in common-law jurisdictions "lie in its emphasis on private contracting and standardized disclosure, and in its reliance on private dispute resolution using market-friendly standards of liability." *Id.* at 23.

ameliorated when suits resembling suits brought under Rule 10b-5 are brought in state court based on state blue sky laws or common law; rather, it is exacerbated. The PSLRA was a response to vexatious federal litigation, but its strictures do not apply in state court. The lack discovery stay and stringent pleading standards in state court proceedings adjudicating claims based on state fraud statutes increases both the cost of the litigation and the incentive to settle, regardless of the merits, to avoid those costs. Also, as illustrated by the present case, state law may provide expanded bases of liability for both individual and class action suits. This Court held in *Blue Chip Stamps* that sound policy dictated that the same claim asserted in *Dabit* could not proceed under Rule 10b-5. The policy arguments against allowing class-action lawsuits asserting the claim in federal court apply in state court. The costs of defending class actions are no less and the difficulties inherent in the holding claim itself are the same.

3. State Courts Recognize that Differences Between State and Federal Regulations Governing Securities Markets Create Costs and Impede Market Efficiency.

State courts recognize that state law can impede market efficiency and increase costs by imposing liability beyond that imposed by federal securities laws. For example, the SEC adopted a regulation to establish uniform practices regarding the payment for order flow. That rule allowed the payments subject to reasonable disclosure requirements. The SEC's less stringent standard conflicted with regulations in a number of states. Addressing that conflict, the New York Court of Appeals held that uniform national rule preempted New York's regulation because enforcing its more stringent standard would cause firms to cease payment for order flow despite the SEC's judgment the practice was beneficial to the

securities market. *Guice*, 674 N.E.2d at 289-91. At least four other states reached the same conclusion. *See McKey v. Charles Schwab & Co.*, 79 Cal. Rptr. 2d 213 (Cal. App. 1998); *Orman v. Charles Schwab & Co.*, 688 N.E.2d 620 (Ill. 1997); *Dahl*, 545 N.W.2d at 925-26; *Shulick v. PaineWebber, Inc.*, 722 A.2d 148 (Pa. 1998); *see also* Rutheford B. Campbell, Jr., *The Insidious Remnants of State Rules Respecting Capital Formation*, 78 Wash. U. L.Q. 407 (2000) (arguing that non-preempted state securities regulations applicable to small issuers increases their capital costs.).

CONCLUSION

The judgment of the Second Circuit should be reversed.

Respectfully submitted,

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November 14, 2005

Syllabus

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Timber & Lumber Co.*, 200 U. S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC. *v.* DABIT

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

No. 04–1371. Argued January 18, 2006—Decided March 21, 2006

Respondent Dabit filed a private securities fraud class action in federal court, invoking diversity jurisdiction to advance his state-law claims that petitioner, his former employer, fraudulently manipulated stock prices, causing him and other brokers and their clients to keep their overvalued securities. The District Court dismissed his amended complaint, finding his claims pre-empted by title I of the Securities Litigation Uniform Standards Act of 1998 (SLUSA), which provides that no "covered class action" based on state law and alleging "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security" "may be maintained in any State or Federal court by any private party." 15 U. S. C. §78bb(f)(1)(A). Vacating the judgment, the Second Circuit concluded that, to the extent the complaint alleged that brokers were fraudulently induced, not to sell or purchase, but to retain or delay selling, it fell outside SLUSA's pre-emptive scope.

Held: The background, text, and purpose of SLUSA's pre-emption provision demonstrate that SLUSA pre-empts state-law holder class-action claims of the kind Dabit alleges. Pp. 5–17.

(a) The magnitude of the federal interest in protecting the integrity and efficiency of the national securities market cannot be overstated. The Securities Act of 1933 and the Securities Exchange Act of 1934 (1934 Act) anchor federal regulation of vital elements of this Nation's economy. Securities and Exchange Commission (SEC) Rule 10b–5, which was promulgated pursuant to §10(b) of the 1934 Act, is an important part of that regulatory scheme, and, like §10(b), prohibits deception, misrepresentation, and fraud "in connection with the purchase or sale" of a security. When, in *Blue Chip Stamps* v. *Manor*

Drug Stores, 421 U. S. 723, this Court limited the Rule 10b–5 private right of action to plaintiffs who were themselves purchasers or sellers, it relied on the widespread recognition that suits by nonpurchasers and nonsellers present a special risk of vexatious litigation that could "frustrate or delay normal business activity," *id.*, at 740. Pp. 5–8.

(b) Similar policy considerations prompted Congress to adopt legislation (Reform Act) targeted at perceived abuses of class actions—*e.g.*, nuisance filings and vexatious discovery requests—but this effort prompted members of the plaintiffs' bar to avoid the federal forum altogether. To stem the shift of class actions from federal to state courts, Congress enacted SLUSA. Pp. 8–10.

(c) Both the class and the securities here are "covered" within SLUSA's meaning, and the complaint alleges misrepresentations and omissions of material facts. The only disputed issue is whether the alleged wrongdoing was "in connection with the purchase or sale" of securities. Dabit's narrow reading would pre-empt only those actions in which *Blue Chip Stamps'* purchaser-seller requirement is met. Insofar as that argument assumes that the *Blue Chip Stamps* rule stems from Rule 10b–5's text, it must be rejected, for the Court relied on "policy considerations" in adopting that limitation, and it purported to define the scope of a private right of action under Rule 10b–5, not to define "in connection with the purchase or sale." When this Court has sought to give meaning to that phrase in the §10(b) and Rule 10b–5 context, it has broadly required that the alleged fraud "coincide" with a securities transaction, an interpretation that comports with the SEC's longstanding views. Congress can hardly have been unaware of this broad construction when it imported the phrase into SLUSA. Where judicial interpretations have settled a statutory provision's meaning, repeating the same language in a new statute indicates the intent to incorporate the judicial interpretations as well. That presumption is particularly apt here, because Congress not only used §10(b)'s and Rule 10b–5's words, but used them in another provision appearing in the same statute as §10(b). The presumption that Congress envisioned a broad construction also follows from the particular concerns that culminated in SLUSA's enactment, viz., preventing state private securities class-action suits from frustrating the Reform Act's objectives. A narrow construction also would give rise to wasteful, duplicative litigation in state and federal courts. The presumption that "Congress does not cavalierly pre-empt state-law causes of action," *Medtronic, Inc.* v. *Lohr*, 518 U. S. 470, 485, has less force here because SLUSA does not pre-empt any cause of action. It simply denies the use of the class-action device to vindicate certain claims. Moreover, tailored exceptions to SLUSA's pre-

Syllabus

emptive command—for, *e.g.*, state agency enforcement proceedings—demonstrate that Congress did not act cavalierly. Finally, federal, not state, law has long been the principal vehicle for asserting class-action securities fraud claims. Pp. 10–16.

(d) Dabit's holder class action is distinguishable from a typical Rule 10b–5 class action only in that it is brought by holders rather than sellers or purchasers. That distinction is irrelevant for SLUSA pre-emption purposes. The plaintiffs' identity does not determine whether the complaint alleges the requisite fraud, and the alleged misconduct here—fraudulent manipulation of stock prices—unquestionably qualifies as a fraud "in connection with the purchase or sale" of securities as the phrase is defined in *SEC* v. *Zandford*, 535 U. S. 813, 820, and *United States* v. *O'Hagan*, 521 U. S. 642, 651. Pp. 16–17.

395 F. 3d 25, vacated and remanded.

STEVENS, J., delivered the opinion of the Court, in which all other Members joined, except ALITO, J., who took no part in the consideration or decision of the case.

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D. C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

SUPREME COURT OF THE UNITED STATES

No. 04–1371

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., PETITIONER *v.* SHADI DABIT

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

[March 21, 2006]

JUSTICE STEVENS delivered the opinion of the Court.

Title I of the Securities Litigation Uniform Standards Act of 1998 (SLUSA) provides that "[n]o covered class action" based on state law and alleging "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security" "may be maintained in any State or Federal court by any private party." §101(b), 112 Stat. 3227 (codified at 15 U. S. C. § 78bb(f)(1)(A)). In this case the Second Circuit held that SLUSA only pre-empts state-law class-action claims brought by plaintiffs who have a private remedy under federal law. 395 F. 3d 25 (2005). A few months later, the Seventh Circuit ruled to the contrary, holding that the statute also pre-empts state-law class-action claims for which federal law provides no private remedy. *Kircher* v. *Putnam Funds Trust*, 403 F. 3d 478 (2005). The background, the text, and the purpose of SLUSA's pre-emption provision all support the broader interpretation adopted by the Seventh Circuit.

I

Petitioner Merrill Lynch, Pierce, Fenner & Smith, Inc.

(Merrill Lynch), is an investment banking firm that offers research and brokerage services to investors. Suspicious that the firm's loyalties to its investment banking clients had produced biased investment advice, the New York attorney general in 2002 instituted a formal investigation into Merrill Lynch's practices. The investigation sparked a number of private securities fraud actions, this one among them.[1]

Respondent, Shadi Dabit, is a former Merrill Lynch broker. He filed this class action in the United States District Court for the Western District of Oklahoma on behalf of himself and all other former or current brokers who, while employed by Merrill Lynch, purchased (for themselves and for their clients) certain stocks between December 1, 1999, and December 31, 2000. See App. 27a–46a. Rather than rely on the federal securities laws, Dabit invoked the District Court's diversity jurisdiction and advanced his claims under Oklahoma state law.

The gist of Dabit's complaint was that Merrill Lynch breached the fiduciary duty and covenant of good faith and fair dealing it owed its brokers by disseminating misleading research and thereby manipulating stock prices.[2] Dabit's theory was that Merrill Lynch used its misinformed brokers to enhance the prices of its investment banking clients' stocks: The research analysts, under management's direction, allegedly issued overly optimistic appraisals of the stocks' value; the brokers allegedly relied on the analysts' reports in advising their investor clients

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[1] Merrill Lynch eventually settled its dispute with the New York attorney general.

[2] The complaint alleged, for example, that the prices of the subject stocks were "artificially inflated as a result of the manipulative efforts" of Merrill Lynch, and that Merrill Lynch, "acting as a central nerve center in the manipulation of various stocks . . . , perpetrated this stock manipulation through a variety of deceptive devices, artifices, and tactics that are the hallmarks of stock manipulation." App. 28a–29a.

and in deciding whether or not to sell their own holdings; and the clients and brokers both continued to hold their stocks long beyond the point when, had the truth been known, they would have sold. The complaint further alleged that when the truth was actually revealed (around the time the New York attorney general instituted his investigation), the stocks' prices plummeted.

Dabit asserted that Merrill Lynch's actions damaged the class members in two ways: The misrepresentations and manipulative tactics caused them to hold onto overvalued securities, and the brokers lost commission fees when their clients, now aware that they had made poor investments, took their business elsewhere.

In July 2002, Merrill Lynch moved to dismiss Dabit's complaint. It argued, first, that SLUSA pre-empted the action and, second, that the claims alleged were not cognizable under Oklahoma law. The District Court indicated that it was "not impressed by" the state-law argument, but agreed that the federal statute pre-empted at least some of Dabit's claims. *Id.*, at 49a–50a. The court noted that the complaint alleged both "claims and damages based on wrongfully-induced purchases" and "claims and damages based on wrongfully-induced holding." *Ibid.* While the "holding" claims, the court suggested, might not be pre-empted, the "purchasing" claims certainly were. The court dismissed the complaint with leave to amend to give Dabit the opportunity to untangle his "hopeless mélange of purchase-related and holding-related assertions." *Ibid.* (punctuation added).

Dabit promptly filed an amended complaint that omitted all direct references to purchases. What began as a class of brokers who "purchased" the subject securities during the class period became a class of brokers who "owned and continued to own" those securities. See *id.*, at 52a.

Meanwhile, dozens of other suits, based on allegations

similar to Dabit's, had been filed against Merrill Lynch around the country on both federal- and state-law theories of liability. The Judicial Panel on Multidistrict Litigation transferred all of those cases, along with this one, to the United States District Court for the Southern District of New York for consolidated pre' ial proceedings. Merrill Lynch then filed its second motion to dismiss Dabit's complaint. Senior Judge Milton Pollack granted the motion on the ground that the claims alleged fell "squarely within SLUSA's ambit." *In re Merrill Lynch & Co., Inc.*, 2003 WL 1872820, *1 (Apr. 10, 2003).

The Court of Appeals for the Second Circuit, however, vacated the judgment and remanded for further proceedings. 395 F. 3d, at 51. It concluded that the claims asserted by holders did not allege fraud "in connection with the purchase or sale" of securities under SLUSA. Although the court agreed with Merrill Lynch that that phrase, as used in other federal securities laws, has been defined broadly by this Court, it held that Congress nonetheless intended a narrower meaning here—one that incorporates the "standing" limitation on private federal securities actions adopted in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U. S. 723 (1975). Under the Second Circuit's analysis, fraud is only "in connection with the purchase or sale" of securities, as used in SLUSA, if it is alleged by a purchaser or seller of securities. Thus, to the extent that the complaint in this action alleged that brokers were fraudulently induced, not to sell or purchase, but to retain or delay selling their securities, it fell outside SLUSA's preemptive scope.[3]

After determining that the class defined in Dabit's

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[3]The Court of Appeals also concluded that Dabit's lost commission claims escaped pre-emption under SLUSA because they did not "allege fraud that 'coincide[s]' with the sale or purchase of a security." 395 F. 3d, at 47 (quoting *SEC* v. *Zandford*, 535 U. S. 813, 825 (2002)). That determination is not before this Court for review.

amended complaint did not necessarily exclude purchasers, the panel remanded with instructions that the pleading be dismissed without prejudice. The court's order would permit Dabit to file another amended complaint that defines the class to exclude "claimants who purchased in connection with the fraud and who therefore could meet the standing requirement" for a federal damages action, and to include only those "who came to hold [a Merrill Lynch] stock before any relevant misrepresentation." 395 F. 3d, at 45–46. Under the Second Circuit's analysis, a class action so limited could be sustained under state law. For the reasons that follow, we disagree.

II

The magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated. In response to the sudden and disastrous collapse in prices of listed stocks in 1929, and the Great Depression that followed, Congress enacted the Securities Act of 1933 (1933 Act), 48 Stat. 74, and the Securities Exchange Act of 1934 (1934 Act), 48 Stat. 881. Since their enactment, these two statutes have anchored federal regulation of vital elements of our economy.

Securities and Exchange Commission (SEC) Rule 10b–5, 17 CFR §240.10b–5 (2005), promulgated in 1942 pursuant to §10(b) of the 1934 Act, 15 U. S. C. §78j(b), is an important part of that regulatory scheme. The Rule, like §10(b) itself,[4] broadly prohibits deception, misrepresentation, and

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[4]Section 10(b) provides as follows:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered . . . any manipulative or deceptive device or contrivance in

fraud "in connection with the purchase or sale of any security."[5] The SEC has express statutory authority to enforce the Rule. See 15 U. S. C. §78u (2000 ed. and Supp. III). Although no such authority is expressly granted to private individuals injured by securities fraud, in 1946 Judge Kirkpatrick of the United States District Court for the Eastern District of Pennsylvania, relying on "the general purpose" of the Rule, recognized an implied right of action thereunder. *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512, 514. His holding was adopted by an "overwhelming consensus of the District Courts and Courts of Appeals," *Blue Chip Stamps*, 421 U. S., at 730, and endorsed by this Court in *Superintendent of Ins. of N. Y.* v. *Bankers Life & Casualty Co.*, 404 U. S. 6 (1971).

A few years after *Kardon* was decided, the Court of Appeals for the Second Circuit limited the reach of the private right of action under Rule 10b–5. In *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461 (1952), a panel composed of Chief Judge Swan and Judges Augustus and Learned Hand upheld the dismissal of a suit brought on behalf of a corporation and a class of its stockholders

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contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U. S. C. §78j(b).

[5]The text of the Rule is as follows:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

"in connection with the purchase or sale of any security." 17 CFR §240.10b–5 (2005).

alleging that fraud "in connection with" a director's sale of his controlling block of stock to third parties violated Rule 10b–5. The court held that the Rule could only be invoked by a purchaser or seller of securities to remedy fraud associated with his or her own sale or purchase of securities, and did not protect those who neither purchased nor sold the securities in question but were instead injured by corporate insiders' sales to third parties. *Id.*, at 464. While the *Birnbaum* court did not question the plaintiffs' "standing" to enforce Rule 10b–5, later cases treated its holding as a standing requirement. See *Eason* v. *General Motors Acceptance Corp.*, 490 F. 2d 654, 657 (CA7 1973).

By the time this Court first confronted the question, literally hundreds of lower court decisions had accepted "*Birnbaum's* conclusion that the plaintiff class for purposes of §10(b) and Rule 10b–5 private damages actions is limited to purchasers and sellers." *Blue Chip Stamps*, 421 U. S., at 731–732. Meanwhile, however, cases like *Bankers Life & Casualty Co.* had interpreted the coverage of the Rule more broadly to prohibit, for example, "deceptive practices *touching* [a victim's] sale of securities as an investor." 404 U. S., at 12–13 (emphasis added); see *Eason*, 490 F. 2d, at 657 (collecting cases). The "judicial oak which ha[d] grown from little more than a legislative acorn," as then-Justice Rehnquist described the rules governing private Rule 10b–5 actions, *Blue Chip Stamps*, 421 U. S., at 737, had thus developed differently from the law defining what constituted a substantive violation of Rule 10b–5. Ultimately, the Court had to decide whether to permit private parties to sue for any violation of Rule 10b–5 that caused them harm, or instead to limit the private remedy to plaintiffs who were themselves purchasers or sellers.

Relying principally on "policy considerations" which the Court viewed as appropriate in explicating a judicially crafted remedy, *ibid.*, and following judicial precedent

rather than "the many commentators" who had criticized the *Birnbaum* rule as "an arbitrary restriction which unreasonably prevents some deserving plaintiffs from recovering damages," 421 U. S., at 738, the Court in *Blue Chip Stamps* chose to limit the private remedy. The main policy consideration tipping the scales in favor of precedent was the widespread recognition that "litigation under Rule 10b–5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Id.*, at 739. Even weak cases brought under the Rule may have substantial settlement value, the Court explained, because "[t]he very pendency of the lawsuit may frustrate or delay normal business activity." *Id.*, at 740. Cabining the private cause of action by means of the purchaser-seller limitation would, in the Court's view, minimize these ill effects. The limitation of course had no application in Government enforcement actions brought pursuant to Rule 10b–5. See *id.*, at 751, n. 14.

III

Policy considerations similar to those that supported the Court's decision in *Blue Chip Stamps* prompted Congress, in 1995, to adopt legislation targeted at perceived abuses of the class-action vehicle in litigation involving nationally traded securities. While acknowledging that private securities litigation was "an indispensable tool with which defrauded investors can recover their losses," the House Conference Report accompanying what would later be enacted as the Private Securities Litigation Reform Act of 1995 (Reform Act), 109 Stat. 737 (codified at 15 U. S. C. §§77z–1 and 78u–4), identified ways in which the class action device was being used to injure "the entire U. S. economy." H. R. Rep. No. 104–369, p. 31 (1995). According to the Report, nuisance filings, targeting of deep-pocket defendants, vexatious discovery requests, and "manipulation by class action lawyers of the clients whom

they purportedly represent" had become rampant in recent years. *Ibid.* Proponents of the Reform Act argued that these abuses resulted in extortionate settlements, chilled any discussion of issuers' future prospects, and deterred qualified individuals from serving on boards of directors. *Id.*, at 31–32.

Title I of the Reform Act, captioned "Reduction of Abusive Litigation," represents Congress' effort to curb these perceived abuses. Its provisions limit recoverable damages and attorney's fees, provide a "safe harbor" for forward-looking statements, impose new restrictions on the selection of (and compensation awarded to) lead plaintiffs, mandate imposition of sanctions for frivolous litigation, and authorize a stay of discovery pending resolution of any motion to dismiss. See 15 U. S. C. §78u–4. Title I also imposes heightened pleading requirements in actions brought pursuant to §10(b) and Rule 10b–5; it "insists that securities fraud complaints 'specify' each misleading statement; that they set forth the facts 'on which [a] belief that a statement is misleading was 'formed'; and that they 'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.'" *Dura Pharmaceuticals, Inc.* v. *Broudo*, 544 U. S. 336, 345 (2005) (quoting 15 U. S. C. §§78u–4(b)(1), (2)).

The effort to deter or at least quickly dispose of those suits whose nuisance value outweighs their merits placed special burdens on plaintiffs seeking to bring federal securities fraud class actions. But the effort also had an unintended consequence: It prompted at least some members of the plaintiffs' bar to avoid the federal forum altogether. Rather than face the obstacles set in their path by the Reform Act, plaintiffs and their representatives began bringing class actions under state law, often in state court. The evidence presented to Congress during a 1997 hearing to evaluate the effects of the Reform Act suggested that this phenomenon was a novel one; state-court litigation of